

Franchise Tax Board**ANALYSIS OF AMENDED BILL**Author: Calderon Analyst: Victoria Favorito Bill Number: AB 1561Related Bills: None Telephone: 845-3825 Amended Date: April 10, 2007Attorney: Doug Powers Sponsor: _____**SUBJECT:** Omnibus Conformity Bill**SUMMARY**

This bill would conform California laws to the federal changes made by the Pension Protection Act of 2006 (PPA) relating to the waiver of the 10% early withdrawal tax on certain distributions from pension plans for public safety employees and distributions from governmental retirement plans for health and long-term care insurance for public safety officers.

SUMMARY OF AMENDMENTS

The April 10, 2007, amendments removed the previous provisions of the bill and added the conformity language discussed in this analysis.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

The author's staff indicates that this is a vehicle that will carry the soon to be amended "Omnibus Conformity Act of 2007."

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy. Thus, it would be effective immediately, and unless otherwise specified, it would apply to distributions beginning on or after December 31, 2006.

POSITION

Pending.

Summary of Suggested Amendments

Technical amendments are necessary and are provided. Department personnel are available to work with the author to resolve any other issues that arise as the bill moves through the legislative process.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Lynette Iwafuchi
for Selvi Stanislaus

5/21/07

ANALYSIS

FEDERAL/STATE LAW

Current Federal Law

Prior to the PPA, a taxpayer who received a distribution from a qualified retirement plan prior to age 59½, death, or disability generally was subject to a 10% early withdrawal tax on the amount includible in income, unless an exception to the tax applied. The early distribution tax did not apply to distributions made to an employee who separated from service after age 55, or to distributions that were part of a series of substantially equal periodic payments made for the life (or life expectancy) of the employee or the joint lives (or life expectancies) of the employee and his or her beneficiary.

Under the PPA, the 10% early withdrawal tax does not apply to distributions from a governmental defined benefit pension plan to a qualified public safety employee who separates from service after age 50. A qualified public safety employee is an employee of a state or political subdivision thereof if the employee provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such state or political subdivision.

Current California Law

California conforms to Internal Revenue Code (IRC) section 72, relating to early withdrawal tax, as of the "specified date" of January 1, 2005, in Revenue and Taxation Code (R&TC) section 17081, with modifications in R&TC section 17085, including the modification of the early withdrawal tax to be 2½% for California purposes, rather than 10% for federal purposes. Therefore, because the PPA changes were made after the "specified date," this federal change to IRC section 72 does not automatically apply.

Thus, until California conforms to this federal law waiver, California will use the IRC section 72 rules that existed on the "specified date," including imposing the 2½% early withdrawal tax on these distributions, while for federal purposes the old IRC section 72 rules will no longer apply.

THIS BILL

This bill would conform the R&TC to the PPA changes made to the IRC relating to the waiver of the 10% early withdrawal tax on certain distributions of pension plans for public safety employees and distributions from governmental retirement plans for health and long-term care insurance for public safety officers. In addition, this bill would make the effective dates of the federal provisions applicable for state tax purposes by providing that the state conformity would apply to the same transactions and the same years as applicable for federal purposes.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

TECHNICAL CONSIDERATIONS

This bill provides language that amends state provisions referencing IRC sections 402 and 403. California automatically conforms to the PPA changes to IRC sections 402 relating to employee benefit plans. Also, section 828 of the PPA did not amend IRC section 403; instead, the act section amended IRC section 72(t). Therefore, it is not necessary to provide language to amend these state provisions. Amendments 1, 2, and 3 are provided to delete the unnecessary language.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

Michigan and New York conform to the federal waiver of the 10% early withdrawal tax on certain distributions from a governmental defined pension plans to a qualified public safety employee who separates from service after age 50. *Florida, Illinois, Massachusetts, and Minnesota* have not conformed to the federal changes relating to the waiver of the 10% early withdrawal tax.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the Personal Income Tax and Corporation Tax revenue loss from this bill would be as follows:

Estimated Revenue Impact of AB 1561 Operative For Distributions Made On Or After December 31, 2006 Enactment Assumed After June 30, 2007			
	2007-08	2008-09	2009-10
Penalty Waiver	Loss <\$150,000	Loss < \$250,000	Loss < \$250,000

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The projected loss in revenue is the decrease in collection of taxes imposed on early withdrawals. Based on the federal estimate, with modifications, conformity would result in insignificant losses of less than \$150,000 in the 2007-08 fiscal year and negligible losses of less than \$250,000 per fiscal year thereafter.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1561
As Amended April 10, 2007

AMENDMENT 1

On pages 3, ~~strikeout~~ lines 9 to 40, inclusive, and on page 4, ~~strikeout~~ lines 1 to 31, inclusive.

AMENDMENT 2

On page 4, line 32, ~~strikeout~~ "SEC. 4." and insert:

SEC. 2.

AMENDMENT 3

On page 4, line 36, ~~strikeout~~ "SEC. 5." and insert:

SEC. 3.